

A fiscal anchor for South Africa

Avoiding the mistakes of the past

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Please refer to the glossary on the BER's website for explanations of technical terms.

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Introduction

“[The] true test of rules occurs in good times when economic plenitude spurs voters and interest groups to demand more of government and politicians respond with tax cuts or spending increases. The seeds of most fiscal collapses are sown during good times”. –Allen Schick (2003)

South Africa’s sovereign debt-to-GDP ratio has more than tripled since 2008, and along with this rapid increase, so have debt-servicing costs. This situation has raised concerns over South Africa’s fiscal sustainability.

Fiscal credibility has been eroded. This is in part because National Treasury (NT) has not met its own forecasts (to some extent due to an underperforming economy) and stated intentions to stabilise debt. Indeed, while NT first communicated the intent to stabilise debt in the 2010/11 financial year already, stabilisation has not yet been achieved. This raises concerns about South Africa’s fiscal credibility.

The International Monetary Fund (IMF) has recommended that South Africa adopt fiscal rules, and their most recent staff concluding statement of the 2024 Article IV Mission noted that:

“A more-ambitious-than-envisaged fiscal consolidation is necessary to place public debt on a sustained downward path.”

and

“A fiscal rule anchored in a prudent debt ceiling can help underpin the consolidation and support policy credibility.”

Before the latest IMF recommendation, NT had already committed to a process of consultations on fiscal rules/anchors. As noted in the 2024 Mid-Term Budget Policy Statement (MTBPS), a discussion document will be released by the end of March 2025.

Fiscal rules are defined as constraints on fiscal policy, typically defined in terms of an indicator of overall fiscal performance or numerical limits on budgetary aggregates. These limits set boundaries to fiscal policy that should not be changed frequently and should provide operational guidance. Furthermore, fiscal rules generally refer to rules that set limits on a large share of public finances, as opposed to rules limited to fiscal sub-aggregates, however, there are some cases of fiscal rules that target sub-national governments specifically.

There are four general types of rules:

- 1) debt rules, which set limits on debt-to-GDP ratios,
- 2) budget balance rules, which set targets for budget balances, normally expressed as a percentage of GDP,
- 3) expenditure rules, which set limits to public expenditure growth and
- 4) revenue rules which set targets for revenue collection, or limits tax burden. Most of these categories have different variations, most notably to adjust targets for economic cycles.

Empirically, fiscal rules have a mixed track record. However, in the South African context, fiscal rules might be useful to build consensus around the need to improve fiscal credibility and sustainability going forward, especially during periods of “economic plenitude”.

Furthermore, it could have positive signalling value to markets. Therefore, credible numerical fiscal rules could, at least partially, assist South Africa in addressing its fiscal challenges. But fiscal rules are not a silver bullet and will not, in isolation, improve South Africa's fiscal sustainability without political buy-in, and without the necessary institutional arrangements. Ironically, if designed poorly, or reneged on soon after its adoption, fiscal rules could erode South Africa's fiscal credibility even further.

However, the true benefit of a fiscal rule is to outline how NT will respond under a variety of different scenarios. It could guide the market on how the government would respond to improved revenue – will it spend the money, or pay down debt? Conversely, if the economy underperforms, how will NT respond? NT's response function during a period of "plenitude" is arguably more important than during downturns – previous periods of strong economic growth were associated with significant increases in spending, which sowed the seeds of the current fiscal problems. Government wages were increased and tax rates reduced. When growth stalled, it was politically very difficult to reduce government wages and raise taxes.

In this note, we outline a possible fiscal anchor that differentiates between an initial ultimate objective (the "outcome"), an intermediate measurable objective and an operational tool.

Taking a "theory of change" approach, we set out a three-prong approach:

- **Debt stabilisation should be the initial ultimate outcome.** An unmanaged increase in debt is closely associated with a deterioration in fiscal sustainability. However, the debt-to-GDP ratio cannot be directly targeted – it depends on a range of factors, some of them within the fiscal authority's control, and others not.
- **A debt-stabilising primary balance is proposed as a minimum and an 'intermediate measurable objective.'** This provides an easy-to-measure approach.
- **Government consumption spending as a share of GDP is proposed as the operational objective.** We propose that government investment spending should be excluded from the target variable to ensure that growth-enhancing fiscal spending is not adversely affected. We argue that in previous years, a nominal expenditure ceiling led to the adverse impact of cuts in infrastructure spending as an 'easy way' of achieving the expenditure ceiling.
- **Once debt has definitively stabilised, the next phase would be to reduce debt, and to introduce a suitable debt anchor.** This should be achieved by targeting a debt-reducing primary balance as the intermediate objective and operationalised through a government expenditure rule.

The policy problem

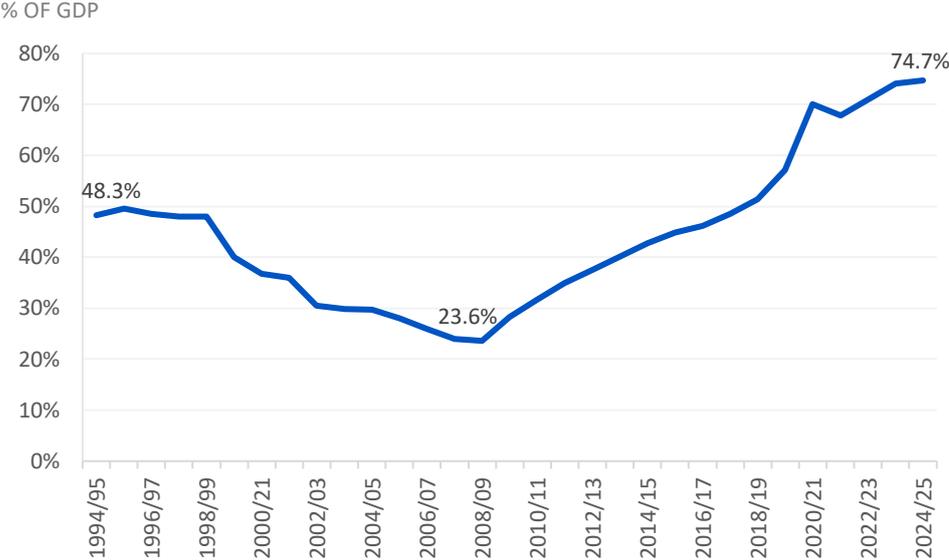
FISCAL DETERIORATION AND SUSTAINABILITY

Since the 2008/09 financial year, South Africa's debt-to-GDP ratio and debt-servicing costs have increased dramatically. The debt-to-GDP ratio has increased from 23.6% to an estimated

74.7% in 2024/25 (see figure 1)¹. In addition, debt-servicing costs have increased from 8.8% of main budget revenue in 2008/09 to an estimated 21.6% in 2024/25 (See figure 2).

As a result, debt-servicing costs have been the fastest-growing expenditure item in the South African national budget for several years, with clear crowding out effects. For example, public expenditure on debt-servicing costs exceeds expenditure on public health care, social protection, or basic education.

Figure 1: Gross Loan Debt-to-GDP Ratio from FY1994/95 to FY2024/25



Source: IMF World Economic Outlook Database and National Treasury Data

Furthermore, the rate of increase in debt-servicing costs as a percentage of revenue has been significantly faster in South Africa than in its peers² (See figure 3). This corresponds with the fact that the average slope of South Africa’s yield curve has been steeper than most emerging and advanced economies since 2010³.

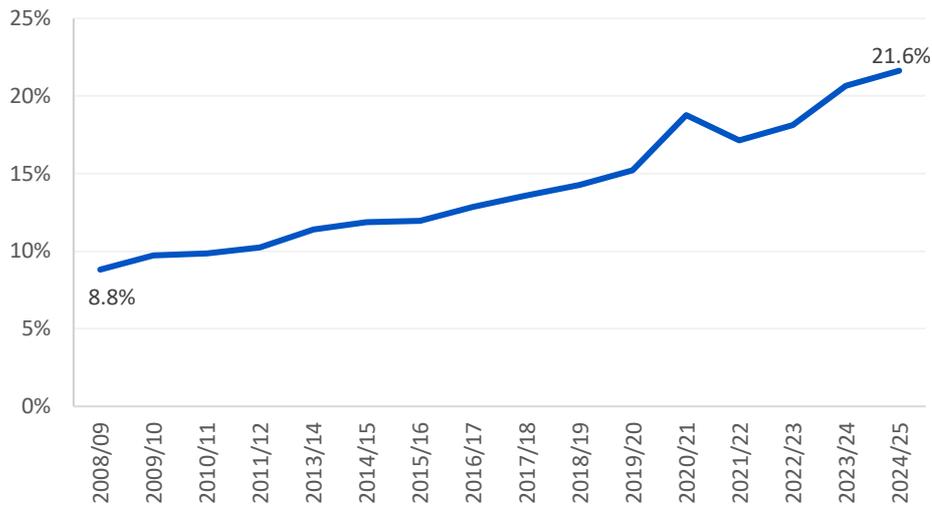
¹ MTBPS 2024 estimated the debt-to-GDP ratio at 74.7% for 2024/25, and GDP growth at 1.1% for 2024. However, since then Stats SA released GDP statistics for quarter 3 of 2024, which indicated a quarter-on-quarter contraction of 0.3%, and a nine-month over nine-month growth rate of 0.4%. This is much weaker growth than what was expected, and as a result, the debt-to-GDP ratio for 2024/25 will likely be higher than what was estimated in MTBPS 2024.

² (MTBPS 2024)- Consists of 94 emerging market economies

³ R., & Steenkamp, D. (2022). South Africa’s yield curve conundrum. University Library of Munich, Germany. <https://ideas.repec.org/p/pramprapa/115398.html>

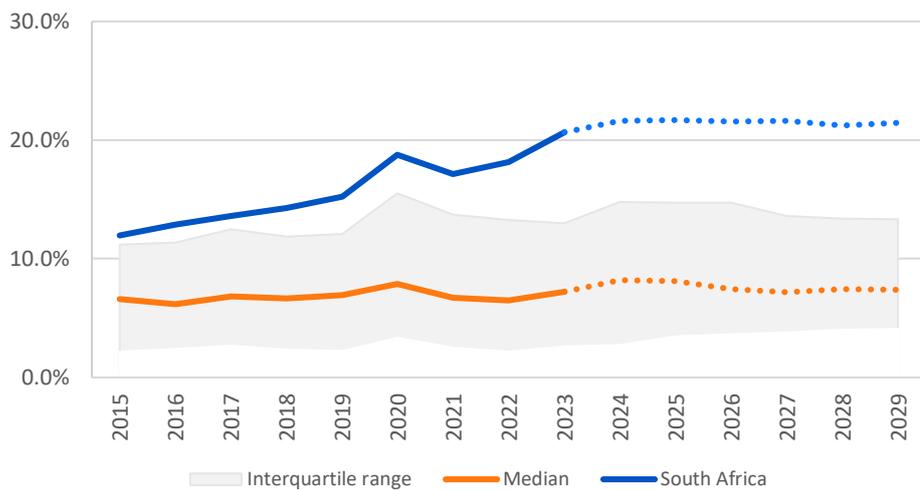
Figure 2: Debt-servicing costs as a share of Main Budget Revenue, FY2008/09 to FY2024/25

% OF MAIN BUDGET REVENUE



Source: Calculated using data from the National Treasury

Figure 3: South Africa's debt-service costs compared with peers



Source: MTBPS 2024

This rapid debt accumulation, in the presence of low public expenditure multipliers, has likely weakened economic growth in South Africa⁴. It is estimated that South Africa's public expenditure multipliers have been close to zero or negative from at least 2014 onwards⁵.

This fiscal deterioration, and the fact that average interest rates on net government debt exceed the long-term nominal economic growth rate has put South Africa's fiscal sustainability

⁴ Soobyah, L., & Steenkamp, D. (2020). Term premium and rate expectation estimates from the South African yield curve (Working Papers 9998). South African Reserve Bank. www.resbank.co.za/content/dam/sarb/publications/working-papers/2020/9998/WP-2003.pdf

⁵ Van Rensburg, T. J., De Jager, S., & Makrelov, K. H. (2022). Fiscal multipliers in South Africa after the global financial crisis. South African Journal of Economic and Management Sciences, 25(1). <https://doi.org/10.4102/sajems.v25i1.4191>

Hausmann, R., Sturzenegger, F., Goldstein, P., Muci, F., Barrios, D., & UNU-WIDER. (2022). Macroeconomic risks after a decade of microeconomic turbulence: South Africa (2007–2020) (WIDER Working Paper 2022; WIDER Working Paper, Vol. 2022). UNU-WIDER. <https://doi.org/10.35188/UNU-WIDER/2022/134-1>

at risk. From a conceptual level “Fiscal sustainability is the ability of a government to maintain public finances at a credible and serviceable position over the long term”⁶. Moreover, if a country is running a deficit, or not a sufficient surplus, and if average interest rates on net government debt exceeds the long-term nominal economic growth rate ($r > g$), it is deemed fiscally unsustainable.⁷ Using this framework, South Africa’s fiscal sustainability is in question, in other words, the average interest rates on net government debt exceed the nominal growth rate, so $r > g$, and South Africa is not running a sufficient balance to offset the fact that $r > g$, and as such, the current fiscal position is unsustainable⁸.

A significant uncertainty going forward is whether the markets’ cautious optimistic sentiment towards the Government of National Unity established in mid-2024 will persist and alter the relationship between interest rates and economic growth rates. If the improved sentiment does not last or does not alter the relationship between average interest rates on government debt and growth rates enough, South Africa’s fiscal sustainability will remain in question.

FISCAL CREDIBILITY

Fiscal credibility can be considered as whether markets and economic agents believe that what treasuries, in this case the NT, announce will happen with a reasonable margin of error.

South African fiscal policy has been time-inconsistent⁹ which, over time, has led to the loss of credibility. The fiscal path under the non-interest expenditure ceiling led to the expectations that fiscal consolidation would occur. As explained in Havemann & Hollander (2024) “Households, firms and monetary policymakers adjusted their expectations about the path of fiscal borrowing. As in a repeated game, the Treasury quickly lost credibility when its announced fiscal consolidation did not materialize.”¹⁰

There seems to be a consensus that South Africa’s fiscal credibility has eroded significantly over the last decade. However, the NT as an institution is held in high regard. The sources of credibility erosion are as follows:

- **Time-inconsistency and (non) credible commitment to debt stabilisation:** The first issue that undermines fiscal credibility in the South African context is that in response to the rapid increase in debt and debt-servicing costs, the NT has communicated the intent to stabilise debt since 2010/11. However, this has not materialised, and debt stabilisation levels have continuously been lifted higher, and stabilisation years have been pushed out. Since 2010/11, the expected debt stabilisation year has been changed 10 times, from the initial

⁶ OECD (2013), “Fiscal sustainability”, in Government at a Glance 2013, OECD Publishing, Paris. DOI: https://doi.org/10.1787/gov_glance-2013-11-en

⁷ Blanchard, O. (2019). Public Debt and Low Interest Rates. American Economic Review, 109(4), 1197–1229. <https://doi.org/10.1257/aer.109.4.1197>

⁸ Havemann, R., Hollander, H., & UNU-WIDER. (2022). Fiscal policy in times of fiscal stress: Or what to do when $r > g$ (WIDER Working Paper 2022; WIDER Working Paper, Vol. 2022). UNU-WIDER. <https://doi.org/10.35188/UNU-WIDER/2022/183-9>

⁹ Time inconsistency refers to policymakers that set policy at time t_0 , but then having an incentive to renege on that policy at time t_1 . (As used in Havemann & Hollander (2024))

¹⁰ Havemann, R., & Hollander, H. (2024). Fiscal policy in times of fiscal stress (or what to do when $r > g$). Journal of Policy Modeling, 46(5), 1020–1054. <https://doi.org/10.1016/j.jpolmod.2024.07.001>

stabilisation year of 2015/16 to 2025/26. The debt stabilisation level has been changed 13 times, from the initial stabilisation level of 40% to 75.5%.

Overall, this has created a credible commitment problem and an impression that commitments are not fully supported by changes in fiscal policy.

- **Over-optimism in forecasting of macroeconomic variables:** Over-optimism in forecasting by the NT is prevalent in GDP, revenue, debt, and inflation forecasts, all of which impact fiscal performance matrices, such as debt-to-GDP ratios. For example, on average over the last 10 years, GDP growth forecasts by the NT were 0.5 percentage points higher than the actual performance in the first years of the MTEF, and 1.6 and 2.3 percentage points higher in the second and third years of the MTEF, whereas revenue projections had even a greater positive bias¹¹. To NT's credit, the South African economy has underperformed relative to the expectations of most economic forecasters in recent years. The large COVID-19 shock (which not only impacted macro variables but also required unexpected intervention from NT) negatively impacts the forecast performance of NT when considering this over the last ten years. Still, although a positive bias in projections is not unique to South Africa, the relative significance of the error size is particularly consequential in a low economic growth environment.
- **Increasing expenditure pressures:** As expenditure pressures intensified over more than a decade, while financing conditions became less favourable and economic growth remained slow, maintaining fiscal credibility became more challenging. This point goes beyond fiscal credibility, and includes general policy uncertainty. In practice, this often means that sustainable fiscal policy in one period can easily be rendered unsustainable in the next period because of frequent and unexpected changes to government policies or projects, on top of external shocks. Some of the main sources of pressure come from increased social expenditure pressures, the public sector wage bill, SOEs, and policies and legislation being adopted without clearly identifying the financing requirements.
- **Nominal non-interest expenditure ceiling:** South Africa's existing nominal non-interest expenditure ceiling, which was introduced in 2012, has arguably lost credibility. Furthermore, it is not formally recognised as a fiscal rule by the IMF.

Since its introduction, it has been breached multiple times and has undergone revisions to accommodate exemptions from the ceiling, most notably to accommodate additional expenditure in the form of bailouts to SOEs. This has led to the ceiling losing credibility and relevance and does not send good signals to markets. Furthermore, the objective of the ceiling is not necessarily clearly communicated or understood by markets and the public.

Some also argue that since the introduction of the non-interest expenditure ceiling, fiscal policy has become less responsive to debt levels and the external financing environment. Furthermore, there are concerns that the non-interest expenditure ceiling contributed to a

¹¹ International Monetary Fund. (2024). South Africa: Technical Assistance Report-Fiscal Transparency Evaluation. International Monetary Fund. <https://doi.org/10.5089/9798400271670.019>

“fiscal dominance” regime in South Africa¹² whereby fiscal policy indirectly limits the options of the South African Reserve Bank (SARB).

Can fiscal rules restore credibility?

Fiscal rules are long-lasting constraints on fiscal policy through numerical limits on budgetary aggregates. These limits are typically defined in terms of an indicator of overall fiscal performance or numerical limits on budgetary aggregates. These limits set boundaries to fiscal policy that should not be changed frequently and should provide operational guidance to governments¹³. As such, fiscal rules are often used as a mechanism to restore fiscal credibility. Fiscal rules typically aim to ensure fiscal responsibility, debt sustainability, and fiscal credibility through correcting distorted incentives and containing pressures to overspend, particularly in good times.

There are four general types of rules:

- **Debt rules:** Set limits to public debt either in nominal terms or as a ratio to GDP.
- **Budget balance rules:** Set targets for budget balances, normally expressed as a percentage of GDP. Different balances can be targeted:
 - i) the overall budget balance which considers all expenditure
 - ii) the primary balance which excludes interest expenditure
 - iii) structural balances which are adjusted for the business cycle, and one-off expenditure items
 - iv) a current balance, which excludes capital expenditure.
- **Expenditure rules:** Set limits to public spending by limiting expenditure growth rates or capping public expenditure expressed as a share of GDP.
- **Revenue rules** Set targets for revenue collection or limit tax burden. As such, they set upper or lower limits to revenue collection, often expressed by limiting revenue collection growth rates or by setting a limit expressed as a share of GDP. Revenue rules can also govern the use of revenue overshoots, for example when more revenue is collected than budgeted for.

Fiscal rule strength is measured by considering its legal basis, coverage, enforcement characteristics, supporting procedures and institutions, and flexibility¹⁴. In terms of a fiscal rule’s legal basis, fiscal rules are normally considered weak if it is merely a political or administrative commitment. Higher thresholds for overriding fiscal rules are correlated with greater enforcement and performance, and as such, statutory or even constitutional legal status

¹² Soobyah, L., Mamburu, M., & Viegi, N. (2023). Is South Africa falling into a fiscal-dominant regime? WP/23/02. South African Reserve Bank. <https://www.resbank.co.za/content/dam/sarb/publications/working-papers/2023/WP%202302.pdf>

¹³ Cangiano, M., Lazare, M., Curristine, T., & Internationaler Währungs fonds (Eds.). (2013). Public financial management and its emerging architecture. International Monetary Fund.

¹⁴ Schaechter, A. (2012). Fiscal rules in response to the crisis: Toward the “next generation” rules: a new dataset. International Monetary Fund. <https://www.imf.org/external/pubs/ft/wp/2012/wp12187.pdf>

improves the strength of fiscal rules¹⁵. Enforceability normally depends on whether formal enforcement mechanisms and procedures are in place. This includes whether there are monitoring mechanisms of compliance outside the government.

Broader coverage increases the strength of fiscal rules. In other words, multiple and ad hoc exceptions to the rule weaken it. This also relates to whether the rule is limited to the central government or the wider public sector. Supporting procedures and institutions mainly relate to independent bodies such as a fiscal council setting budget assumptions and monitoring budget implementation. However, it could also include whether there are multi-year expenditure ceilings and fiscal responsibility laws¹⁶.

Flexibility refers to whether there are clearly defined escape clauses. Well-designed escape clauses should clearly define situations where the rule is set aside, and how to return to the rule. An additional factor of flexibility is whether fiscal aggregates, especially balances are defined in cyclically adjusted terms.

It is also argued that a “strong rule” is one that is applied ex-post and ex-ante¹⁷. This concept is linked to reducing bias in forecasting, “fiscal gimmickry”¹⁸ and links to the concept of building in “claw-back” mechanisms into fiscal rule design.

Prevalence of fiscal rules

As of the end of 2021, 105 countries adopted at least one fiscal rule¹⁹. It is also more common for countries to combine different types of rules, with the most common combination being a combination of a budget balance rule, an expenditure rule and a debt rule (35 countries), followed by a debt rule with a budget balance rule (26 countries)²⁰. Table 1 provides a breakdown of fiscal rules adopted across the world.

¹⁵ Ibid

Inman, R. (1996). Do Balanced Budget Rules Work? U.S. Experience and Possible Lessons for the EMU (w5838; p. w5838). National Bureau of Economic Research. <https://doi.org/10.3386/w5838>

¹⁶ The primary goal of fiscal responsibility laws is to increase accountability and transparency in fiscal processes. South Africa’s Public Finance Management Act of 1999 is a form of a fiscal responsibility law.

¹⁷ Inman, R. (1996). Do Balanced Budget Rules Work? U.S. Experience and Possible Lessons for the EMU (w5838; p. w5838). National Bureau of Economic Research. <https://doi.org/10.3386/w5838>

¹⁸ Describe the use of creative accounting or one-off measures by governments to take advantage of accounting conventions when fiscal rules are in place or threatened.

¹⁹ Davoodi, H., Elger, P., Fotiou, A., Garcia-Macia, D., Han, X., Lagerborg, A., Lam, W., & Medas, P. (2022). Fiscal Rules and Fiscal Councils: Recent Trends and Performance during the COVID-19 Pandemic. International Monetary Fund. <https://www.imf.org/en/Publications/WP/Issues/2022/01/21/Fiscal-Rules-and-Fiscal-Councils-512128>

²⁰ (Davoodi et al. 2002) & Calitz, E., & Siebrits, K. (2023, August). Fiscal anchors and sustainable fiscal policy. World Institute for Development Economic Research (UNU-WIDER). <https://www.wider.unu.edu/sites/default/files/Publications/Working-paper/PDF/wp2023-98-fiscal-anchors-sustainable-fiscal-policy.pdf>

Table 1: Adopted Fiscal Rules across the world as at 2021

| Rule or combination of rules | Number of Countries |
|---|---------------------|
| Expenditure rule | 2 |
| Debt rule | 5 |
| Budget balance rule | 8 |
| Subtotal | 15 |
| Revenue rule + Expenditure rule + Debt rule | 1 |
| Revenue rule + Debt rule | 2 |
| Expenditure rule + Debt rule | 2 |
| Revenue rule + Expenditure rule + Budget balance rule + Debt rule | 5 |
| Revenue rule + Budget balance rule + Debt rule | 9 |
| Expenditure rule + Budget balance rule | 10 |
| Budget balance rule + Debt rule | 26 |
| Expenditure rule + Budget balance rule + Debt rule | 35 |
| Subtotal | 90 |
| Total | 105 |

Source: Siebrits & Calitz (2023)

Different rules have different trade-offs. Some rules may have strong stabilisation characteristics. However, this could make the rule more complicated and comes at the cost of simplicity, which makes communication, monitoring and enforcement difficult²¹. Therefore, it has become practice to combine different fiscal rules, and in the process of combining rules, it is recommended that trade-offs are minimised and the interaction of multiple rules is considered to avoid inconsistencies of targets.

Pros and Cons of different rules

Overall, the most common anchoring rules are debt rules with the main advantage of being directly linked to debt sustainability and they are easy to communicate and monitor²².

However, the disadvantage is that debt rules do not provide clear operational guidance for budgets. Furthermore, they do not have strong economic stabilisation features, which could easily lead to pro-cyclical fiscal policy. Moreover, debt and debt ratios are significantly affected by factors that are outside a government's control.

Budget balance rules that are not adjusted for economic cycles are relatively easy to communicate and monitor. In addition, it has a direct link to debt stabilisation and provides a form of operational guidance to governments. However, it can lead to pro-cyclicality. For example, in the lead-up to the Great Financial Crises (GFC), balance targets were interpreted as norm deficits, as opposed to maximum deficits, which misguided incentives to borrow more

²¹ Eyraud, L., Dudine, P., Lledo, V. D., & Peralta-Alva, A. (2018). How to Select Fiscal Rules. International Monetary Fund.

²² Schaechter, A. (2012). Fiscal rules in response to the crisis: Toward the "next generation" rules: a new dataset. International Monetary Fund. <https://www.imf.org/external/pubs/ft/wp/2012/wp12187.pdf>

during “good” times and increased the overall fiscal risks for governments²³. In addition, it can adversely impact the composition of public expenditure towards greater current expenditure and crowd out capital expenditure. Furthermore, headline balances are affected by developments outside the control of governments. To this point, in the South African case, it is sometimes argued that revenue is possibly too volatile to target budget balances.

To address the issue of pro-cyclicality, balances can be adjusted to account for economic cycles, and certain once-off expenditures can be excluded from balances. However, adjusting for cycles can be imprecise and complicated especially if a country is undergoing structural changes, which complicates the monitoring and communication of rules. There are also concerns over the accuracy of estimating where a country finds itself in a cycle. Furthermore, excluding once-off expenditures from budget balances also raises concerns, especially in relation to the adequacy and coverage when there is significant room for exceptions, which weakens the rule.

Expenditure rules’ main advantages are that they provide clear operational guidance, and it is also possible for it to allow for automatic economic stabilisers. In addition, it contains the size of governments, and is easy to monitor, communicate and enforce compliance. Furthermore, public expenditure is under the direct control of the government. Another advantage as compared to balance rules is that expenditure rules are generally better at containing fiscal policy during economic upswings. However, it is sometimes argued that the weakness of expenditure rules is that they do not necessarily have a direct link to debt stabilisation given that no parameters on revenue are set. Furthermore, it could lead to adverse effects on the composition of public expenditure, similar to budget balance rules.

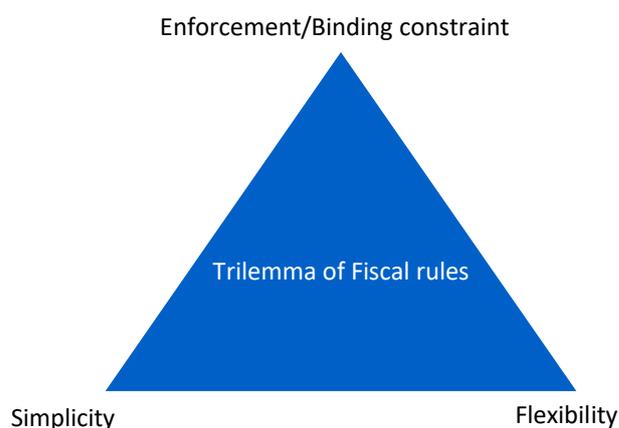
Revenue rules can be used to contain the size of governments and improve revenue policies and administration. However, this does not have a direct link to debt stabilisation since it does not set limits to government expenditure except for possibly dictating the use of revenue windfalls. Furthermore, these rules are prone to lead to procyclical fiscal policy. Moreover, although governments have control over tax policy, there are many factors influencing revenue that is outside the control of governments, and in many countries, especially commodity-exporting countries, such as South Africa, revenue is volatile.

Furthermore, although it has become common practice to combine rules to minimise shortcomings, it is often argued that there is a trilemma. Based on this trilemma only two of the three properties of enforceability, flexibility, and simplicity can be incorporated simultaneously in the design of a fiscal rule. As such, different combinations of rules also have different trade-offs²⁴.

²³ Schick, A. (2003). The Role of Fiscal Rules in Budgeting. OECD Journal on Budgeting, 3(3), 7–34. <https://doi.org/10.1787/budget-v3-art14-en>

²⁴ Debrun, X., and L. Jonung (2019). ‘Under Threat: Rules-based Fiscal Policy and How to Preserve It’. European Journal of Political Economy, 57: 142–57. <https://doi.org/10.1016/j.ejpoleco.2018.09.00>

Figure 4: The trilemma of fiscal rules



Effectiveness of fiscal rules

Empirically, the track record of fiscal rules is mixed, and functions in the broader institutional context of a country. The design of rules impacts the effectiveness, and they do not work in isolation from the wider institutional context. As such, a supportive institutional framework and political buy-in is essential for the effectiveness of fiscal rules. In the correct setting, fiscal rules can be effective signalling tools, credibility enhancing and a measure to bolster fiscal policy continuity.

SUSTAINABILITY

Overall, compliance with fiscal rules is often relatively low. For example, using a sample of 90 countries, Davoodi et al. (2022) found that over the period from 2004 to 2021, compliance with budget balance rules and debt rules was 42 and 50 per cent, respectively.

Despite erratic compliance and challenges, various authors argue that numerical rules are still effective. In a European setting, assessing the period from 1994 to 2012, Reuter (2015)²⁵ demonstrated empirically that having fiscal rules in place, “tilted” fiscal policy variables towards numerical constraints, especially after economic shocks or slippages. In the United Kingdom (UK), Tetlow et al. (2024)²⁶ argued that despite compliance challenges, the fiscal position and future of the UK would likely have been worse than in the absence of fiscal rules.

Studies suggest that only “strong rules” are effective in an emerging market context. Performance under “weak” fiscal rules sometimes yields poorer results than under circumstances without fiscal rules. Ardanaz et al. (2023)²⁷ compared the impact of national fiscal rules on debt performance over the period of 2000 to 2019. Without differentiating between the

²⁵ Reuter, W. H. (2015). National numerical fiscal rules: Not complied with, but still effective? *European Journal of Political Economy*, 39, 67–81. <https://doi.org/10.1016/j.ejpoleco.2015.04.002>

²⁶ Tetlow, G., Bartrum, O., & Pope, T. (2024). Strengthening the UK’s fiscal framework. Putting fiscal rules in their place. Institute for Government. <https://www.instituteforgovernment.org.uk/sites/default/files/2024-02/strengthening-uk-fiscal-framework.pdf>

²⁷ Ardanaz, M., Cavallo, E. A., & Izquierdo, A. (2023). Fiscal Rules: Challenges and Reform Opportunities for Emerging Markets. Inter-American Development Bank. <https://doi.org/10.18235/0004671>

strength of rules, the results showed no impact on performance, and on some metrics, countries with rules had poorer performance than countries without rules. However, after accounting for rule strength²⁸, the result showed differences. On average debt-to-GDP growth was 3 percentage points lower with a strong fiscal rule as opposed to weak or no rules. To complement this finding, Heinemann et al., 2018²⁹, also found that if fiscal rules are not “strict” enough, they have little effect on constraining fiscal policy.

The complication from an empirical basis is to establish whether there is a causal relationship between fiscal rules and fiscal performance, however, there is at least a correlation. This is due to significant endogeneity in studies on fiscal rules and fiscal performance³⁰. In explanation, a pre-existing cultural or preference for fiscal prudence increases the likelihood of a country adopting fiscal rules, and due to this preference, those countries typically perform well fiscally, regardless of having fiscal rules. However, it is important to note that although a pre-existing culture of fiscal prudence could influence fiscal performance, culture is also formed and influenced over time by institutions, such as fiscal rules.

CREDIBILITY

In terms of credibility and anchoring market expectations, institutions such as fiscal rules, independent watchdogs, and fiscal transparency contribute to the build-up of fiscal credibility³¹. In addition, fiscal slippage, large revisions of targets and surprise or unexpected announcements erode credibility.

Fiscal rules are associated with reducing the gap between market and official forecasts³². Furthermore, having robust multi-year expenditure ceilings also improves credibility by dampening the negative impacts of fiscal surprises. Moreover, it is also argued that having independent “watchdogs” or a fiscal council to monitor budgets and compliance with fiscal rules significantly reduces credibility erosion in the presence of fiscal surprise and can reduce positive biases in forecasting.

²⁸ Consists of broad institutional coverage, statutory or legal basis, the existence of supporting monitoring arrangements, enforcement procedures, and flexibility mechanisms to respond to shocks.

²⁹ Heinemann, F., Moessinger, M.-D., & Yeter, M. (2018). Do fiscal rules constrain fiscal policy? A meta-regression-analysis. *European Journal of Political Economy*, 51, 69–92. <https://doi.org/10.1016/j.ejpoleco.2017.03.008>

³⁰ Heinemann, F., Moessinger, M.-D., & Yeter, M. (2018). Do fiscal rules constrain fiscal policy? A meta-regression-analysis. *European Journal of Political Economy*, 51, 69–92. <https://doi.org/10.1016/j.ejpoleco.2017.03.008>

Heinemann, F., Osterloh, S., & Kalb, A. (2014). Sovereign risk premia: The link between fiscal rules and stability culture. *Journal of International Money and Finance*, 41, 110–127. <https://doi.org/10.1016/j.jimonfin.2013.11.002>

³¹ End, N., & Hong, G. H. (2022). Trust What You Hear: Policy Communication, Expectations, and Fiscal Credibility. IMF Working Paper No. 2022/03. <https://ssrn.com/abstract=4070770>

³² *ibid*

Fiscal Rule Design

There is no specific theoretical framework to guide the selection of fiscal rules and appropriate rule designs may differ depending on country context. However, there are some guiding characteristics and criteria to consider for rule selection, and specifications for rule strength³³.

OBJECTIVES

The key objectives are arguably to ensure fiscal sustainability and fiscal credibility. Considering South Africa's fiscal deterioration, questions about its sustainability, and erosion of fiscal credibility, it could also be argued that the key objectives in the South African context should be to address these challenges. This notion would be in line with the IMF's latest recommendation for South Africa to introduce a clear fiscal rule that strikes a balance between credibility, debt stabilisation, and flexibility³⁴. It is critical that fiscal rules' objectives are clear to the public and markets. Therefore, it can be argued that they should be the departure point for designing appropriate fiscal rules.

Overall, there is a view that debt stabilisation should be the initial objective for fiscal rules in the South African context, but this is likely not sufficient. In relation to the latter, the argument is that markets would like to see debt reduction as opposed to stabilisation. This is mainly due to the risk of possible unforeseen shocks, where any adverse shock at this point would send South Africa into a debt spiral and deeper into unsustainability.

The objective of fiscal rules can also be considered as achieving fiscal sustainability as a prerequisite for growth in the South African context. This view considers fiscal rules from a Theory of Change approach, whereby the end goal is economic growth, but for that to take place, fiscal sustainability is arguably one of the key prerequisites.

Another element of the objective is that fiscal rules should assist South Africa in constraining fiscal policy in periods of economic upswings. This notion corresponds to what Schick (2003) describes as *"[The] true test of rules occurs in good times when economic plenitude spurs voters and interest groups to demand more of government and politicians respond with tax cuts or spending increases. The seeds of most fiscal collapses are sown during good times"*.

As such, it can be argued that the objective of fiscal rules in South Africa should be to enhance fiscal credibility, improve fiscal sustainability and provide guidance and restraint, especially during economic upswings.

Indeed, the objective of the existing nominal non-interest expenditure ceiling is not always clear. Although the narrative from the NT over the last decade was that the objective was to stabilise debt, it would appear that the ceiling is an operational rule, without it being anchored in stabilising debt. In defence of the existing ceiling, the main objective initially was to slow down the pace at which public expenditure grew, but it lost credibility and relevance. Expenditure

³³ A useful approach is to use the guiding principles drawn from Kopits & Symansky's (1998) characteristics of a model rule, criteria for rule selection from Eyraud et al. (2018), specification of strong fiscal rules from Inman (1996, p. 21) and components for compiling a fiscal rule index as set out in Schaechter (2012, pp. 28–31).

³⁴ IMF. (2024). South Africa: Technical Assistance Report-Fiscal Transparency Evaluation. International Monetary Fund.

accelerated extensively after the GFC as part of counter-cyclical fiscal policy. Initially, one could argue that the ceiling was successful for that purpose; however, as expenditure items were exempted from the ceiling, most notably bailouts to SOEs, and the ceiling was arguably slow to respond to debt levels and external financing conditions, it lost credibility and relevance. It could also be argued that the current pursuit of fiscal rules is a function of the failure of the existing ceiling.

GUIDING PRINCIPLES FOR DESIGN

The first principle is sustainability and links directly to the stated objective. Sustainability as a principle refers to the point that, with compliance with fiscal rules, long-term debt sustainability should be achieved³⁵. This also links to the concept that rules should be well-defined and adequate. As such, the objective needs to be clearly defined, and so should the indicators it attempts to constrain.

As for adequacy, the indicator or target should be adequately linked to the stated objective³⁶. This is particularly relevant to the South African context, given that in the past, there did not seem to be a link between debt sustainability and the existing non-interest expenditure ceiling. Furthermore, based on the IMF's most recent Fiscal Transparency Evaluation of South Africa, the country does not meet the standard in terms of clear fiscal policy objectives and did not meet the standards in terms of long-term fiscal sustainability analysis³⁷.

Furthermore, the concept of rule coverage also connects well with the requirement of a rule being "well-defined" and adequate. Coverage is a prominent feature in rule strength indicators, and it refers to the degree of exceptions from fiscal aggregates, and whether rules are limited to the central government or expanded beyond the central government. In the event of low coverage and a large number of exemptions, adequacy is reduced³⁸. Moreover, if rules are not well-defined, it creates ambiguity, which undermines coverage. Once again, this relates well to the South African case where exemptions to the existing expenditure ceiling create ambiguity and undermine its coverage and allow for expenditure to be easily justified to bypass the ceiling. To this point, the IMF also flagged the fact that transactions financing bailouts to SOEs are not always in line with international standards³⁹, and this misclassification also undermines the expenditure ceiling's coverage and adequacy, as it facilitates bypasses.

The second major principle is stabilisation qualities, whereby the rule should not increase economic volatility. Therefore, rules should allow for countercyclical changes to taxes and expenditure⁴⁰. This also links to the concept of flexibility used to evaluate whether rules accommodate for exogenous shocks by adjusting for economic cycles, or through well-defined escape clauses⁴¹.

³⁵ Eyraud, L., Dudine, P., Lledo, V. D., & Peralta-Alva, A. (2018). How to Select Fiscal Rules. International Monetary Fund.

³⁶ Kopits, G., & Symansky, S. (1998). Fiscal Policy Rules. International Monetary Fund. <https://doi.org/10.5089/9781557757043.084>

³⁷ (IMF, 2024, pp. 8, 32 & 58)

³⁸ Kopits, G., & Symansky, S. (1998). Fiscal Policy Rules. International Monetary Fund. <https://doi.org/10.5089/9781557757043.084>

³⁹ IMF. (2024). South Africa: Technical Assistance Report-Fiscal Transparency Evaluation. International Monetary Fund.

⁴⁰ Kopits & Symansky (1998) & Schaechter (2012)

⁴¹ Kopits & Symansky (1998) & Schaechter (2012)

Considering South Africa’s fiscal context, it might be more appropriate to focus on containing fiscal policy during economic upswings. Given South Africa’s low public expenditure multipliers, limited fiscal space, and the fact that average interest rates on government debt exceed economic growth ($r > g$), it might be more applicable for rules to be focused less on accommodative features during downturns, but to rather contain fiscal policy during economic upswings. This approach would also be more aligned with the stated objective.

A third major principle is simplicity, whereby it should be easy to understand, communicate and monitor fiscal rules, and compliance⁴². Furthermore, it is argued that for a fiscal rule to be strong, non-compliance should come at a cost, for example, a court overruling budgets that breach targets⁴³. As a practical example, in November 2023, the German Constitutional Court overruled a budget that was passed in the Bundestag but breached Germany’s fiscal rules⁴⁴.

Linking to the previous point, an important element of rule design is independent monitoring of compliance. In addition to compliance, this also includes forecasting evaluations and enforcement mechanisms from independent bodies outside the government, which is closely linked to the notion of having supporting procedures and institutions to implement fiscal rules effectively⁴⁵. This is applicable and important for fiscal rule design in the South African context as South Africa does not meet the standard for independent evaluation of macro-fiscal forecasts, as assessed by the IMF. Furthermore, as noted by the IMF, bodies such as South Africa’s Parliamentary Budget Office (PBO) and the Financial and Fiscal Commission (FFC) could theoretically provide institutional support for the implementation of fiscal rules and evaluation of macro-fiscal forecasts. However, currently, these bodies do not have sufficient capacity or capabilities. As an example, the PBO’s forecasts show even greater positive bias than the NT’s forecasts⁴⁶.

The fifth principle relates to the extent to which the rule design provides operational guidance for fiscal policy. This translates into guidance on annual budgets, and whether targets are largely under the control of the government⁴⁷.

An additional factor is the legal basis for fiscal rules, which is a prominent feature of measuring fiscal rule strength. Higher thresholds for overriding fiscal rules are correlated with greater enforcement and performance, and as such, statutory or even constitutional legal status improves the strength of fiscal rules⁴⁸.

From the guiding principles, the main takeaways for fiscal rule design in the South African context are that it needs to be firmly linked to the objective, coverage should be extensive, and simplicity should be prioritised to maximise its signalling value, and to ease monitoring and

⁴² Eyraud, L., Dudine, P., Lledo, V. D., & Peralta-Alva, A. (2018). How to Select Fiscal Rules. International Monetary Fund.

⁴³ Inman, R. (1996). Do Balanced Budget Rules Work? U.S. Experience and Possible Lessons for the EMU (w5838; p. w5838). National Bureau of Economic Research. <https://doi.org/10.3386/w5838>

⁴⁴ Bundesverfassungsgericht. (2023). Second Supplementary Budget Act 2021 is void. Press Release No. 101/2023 (Press Release 101/2023). <https://www.bundesverfassungsgericht.de/SharedDocs/Pressemitteilungen/EN/2023/bvg23-101.html>

⁴⁵ Schaechter, A. (2012). Fiscal rules in response to the crisis: Toward the “next generation” rules: a new dataset. International Monetary Fund.

⁴⁶ IMF. (2024). South Africa: Technical Assistance Report-Fiscal Transparency Evaluation. International Monetary Fund.

⁴⁷ Eyraud et al. (2018)

⁴⁸ Inman (1996) & Schaechter (2012)

enforcement. Furthermore, the institutional framework needs to be strengthened to enable and enhance independent monitoring and enforcement. In addition, fiscal rules are likely to be more effective if it has statutory status.

BOX 1: A credible fiscal anchor can reduce inflation and the repo rate

Alan Blinder (1982)⁴⁹ approaches fiscal policy through the lens of game theory and considers how the government and the central bank (in charge of monetary policy) strategically interact. Blinder argues that fiscal policy is not made in isolation; it is a coordinated game between the government and the central bank. In this setup, each actor has its own goals and tools, with the government typically aiming for economic growth and employment and the central bank primarily focused on inflation control and financial stability. Blinder's game-theoretic approach highlights the tension between these objectives and the importance of strategic decision-making to achieve optimal outcomes. By considering fiscal policy as a game, he reveals how the government and the central bank can either complement each other's policies or, if misaligned, create undesirable economic consequences, such as high inflation or excessive debt.

More modern approaches suggest fiscal-monetary policy in terms of "leader-follower" games, i.e., where the decisions are not simultaneous. In that case, one policymaker moves first as a Stackelberg leader and another policymaker as a follower.⁵⁰ Either the central bank can lead (for example, by changing interest rates, to which the fiscal authority must respond) or the fiscal authority is the Stackelberg leader since a central bank can change interest rates relatively quickly, whereas a state budget is usually approved on an annual basis and cannot be easily modified.

Whichever way one looks at it, the economic outcomes are improved when the two players coordinate. This can be done with clear rules for each player. If the central bank knows how the Treasury will respond to the economy, then it can design an optimal response. Similarly, the Treasury can set policy understanding how the central bank will respond.

In South Africa, there is rule-based monetary policy; but no rule-based fiscal policy. This leads to a suboptimal outcome – arguably where the central bank keeps interest rates too high not because it thinks the Treasury policy is inflationary, but because it cannot predict the Treasury's actions.

To formally model this, Havemann and Hollander (2024) introduce a "game" into a DSGE model. Reducing government consumption spending is found to bring the least painful fiscal adjustment—welfare is reduced less compared to other options. The demand implications of a consumption-led fiscal consolidation are offset by lower interest rates. These lower interest rates are as a result of two effects. First, the fiscal consolidation reduces the risk of a fiscal crisis, and so reduces the sovereign risk premium. This also reduces borrowing costs for the private sector, stimulating investment. Second, the reduction in government spending is deflationary, allowing the South African Reserve Bank space to reduce the policy rate.

This (endogenous) monetary policy response counteracts the negative demand impact of fiscal policy, leaving growth (g) almost unaffected and even somewhat improved. The effect is likely to

⁴⁹ Blinder, A. S. (1982). *Issues in the coordination of monetary and fiscal policy* (No. w0982). National Bureau of Economic Research.

⁵⁰ Demid, E. (2018). Fiscal and monetary policy: coordination or conflict? *International Economic Journal*, 32(4), 547-571.

be self-reinforcing, in that the reduction in the risk premium will reduce debt-service costs at the margin, further reducing government spending.

An anchor for South Africa?

In this section, we consider possible fiscal anchors for South Africa.

WHAT SHOULD GUIDE THE SETTING OF THE ANCHOR?

Drawing from the literature, we identify the following considerations for a fiscal anchor:

Consideration 1: Political buy-in. Fiscal rules must have sufficient political buy-in to be effective in assisting South Africa in addressing its fiscal challenges.

Consideration 2: Independent monitoring. Given the concerns over the erosion of fiscal credibility in South Africa, independent monitoring should be considered, possibly through a fiscal council.

Consideration 3: Clear differentiation between operational objectives and the ultimate objective. To prevent a repeat of signalling shortcomings of the existing non-interest expenditure ceiling, the ultimate objective of fiscal rules should be clearly communicated and remain consistent. In addition, the ultimate objectives should be to achieve fiscal sustainability, i.e., stabilise or even reduce the debt-to-GDP ratio. Furthermore, in considering the objective, there should be a significant focus on containing fiscal policy during economic upswings or “Economic plenitude”.

Consideration 4: Balance fiscal consolidation with economic growth. There are valid concerns that an aggressive fiscal consolidation will harm economic growth.⁵¹ This will be counterproductive – lower growth will reduce revenue harming fiscal measures.

Any rule that reduces investment spending, for example, is likely to harm growth. Similarly, rapid reductions in the education goods, services and infrastructure budget (schools, textbooks, etc.) will harm long-run growth. On the other hand, stabilising wage growth will have positive economic consequences. Not only will it improve fiscal metrics, but it is also likely to be disinflationary, allowing for monetary policy to gradually ease, supporting further growth (see box).

Consideration 5: Have a statutory basis. Based on international experience, strong fiscal rules tend to be more effective in improving fiscal performance. Therefore, if fiscal rules are pursued, consideration should be given to adopting it into law to have statutory status, as opposed to a mere agreement within the NT or a political agreement.

Consideration 6: The rule must be binding and difficult to break. A significant reason for the non-interest expenditure ceiling to have failed is that it made numerous exceptions to allow for additional expenditure. This links to the concept of rule coverage, whereby a rule is deemed

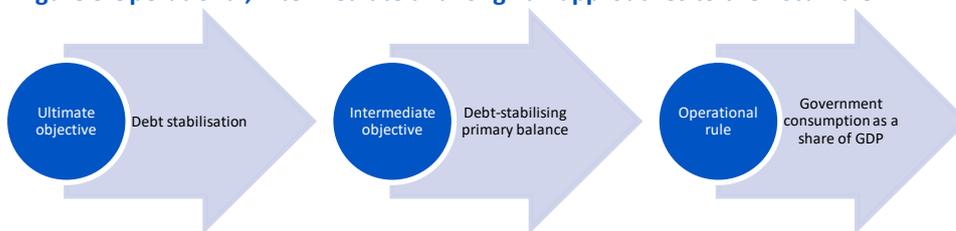
⁵¹ Sachs, M., Amra, R., Madonko, T., & Willcox, O. (2023). Austerity without consolidation: Fiscal policy and spending choices in Budget 2023. Southern Centre for Inequality Studies, University of Witwatersrand.

stronger the more comprehensive the coverage. As such, if fiscal rules are pursued, it should be considered for the rules to have extensive coverage including fiscal support to SOEs.

Consideration 7: More than one rule is possible, but this could add complexity. It has become practice to adopt more than one fiscal rule to address different aspects of fiscal policy challenges, thereby minimising shortcomings of individual rules in isolation. Therefore, if fiscal rules are pursued, it should be considered to adopt more than one fiscal rule, and that exit clauses, with high thresholds, are very clearly defined.

With these considerations in mind, our proposal is to create an initial integrated fiscal rule that differentiates between an operational short-term rule (i.e., one that can guide the budget process), with an intermediate objective, which supports the ultimate objective which is fiscal sustainability. Once debt has definitively stabilised, the next phase would be to reduce debt, and to introduce a suitable debt anchor, to be achieved by targeting a debt-reducing primary balance as the intermediate objective and operationalised through a government expenditure rule.

Figure 5 Operational, intermediate and long-run approaches to the fiscal rule



The three components would be, starting from the initial ultimate objective:

- **Debt stabilisation should be the initial ultimate objective.** The best measure of fiscal sustainability is always the path of debt – inexorably rising debt is an obvious harbinger of impending fiscal collapse, while stable and declining debt is associated with fiscal prudence.
- **Mathematically, debt stabilisation requires a debt-stabilising primary balance.**⁵² The size of the debt-stabilising primary balance is relatively easy to calculate, but achieving it is much more complex. This leads us to propose the next step – the operational rule.
- **An operational rule to guide the budget process.** The budget process needs a clear upfront “rule” that can assist in setting the spending envelope. From the setting of the spending envelope, all other decisions follow (the various allocations). Getting the process right from the start helps to ensure that the ultimate objective is achieved.
- **We propose government consumption spending as a share of GDP as the operational rule.** This is not the perfect measure, but it has a number of advantages. First, it implicitly adjusts for inflation and growth. Secondly, it shifts the focus of the operational rule from revenue to spending. As we note above, using increases in tax rates can be counterproductive. Higher tax rates can lead to lower revenue if the design of the tax is anti-growth. The literature on consolidation suggests that expenditure-led consolidations are generally much more successful.⁵³ Third, relatedly, it allows spending to be set at a level that is both consistent with long-run revenue

⁵² Blanchard, Olivier. (2019). "Public Debt and Low Interest Rates." *American Economic Review*, 109 (4): 1197–1229.

⁵³ Alesina, A., Barbiero, O., Favero, C., Giavazzi, F., & Paradisi, M. (2017). *The effects of fiscal consolidations: Theory and evidence*. National Bureau of Economic Research, Working Paper no. w23385

- generating capacity of the economy *and* with the level that will achieve a debt-stabilising primary balance.
- **Once debt has definitively stabilised, the next phase would be to reduce debt, and to introduce a suitable debt anchor.** This should be achieved by targeting a debt-reducing primary balance as the intermediate objective and operationalised through a government expenditure rule.

BOX 2: Legislating fiscal rules in South Africa

Based on previous attempts to introduce legislated fiscal rules⁵⁴, which had to be certified by the Chief Parliamentary Legal Adviser or a parliamentary legal adviser, proposed legislation on fiscal rules would likely be classified under Section 76 bills. In other words, ordinary bills that affect provinces. Furthermore, based on this experience, fiscal rules would likely not be considered a money bill or a bill that affects equitable share and allocation of revenue (Section 214 bills). Therefore, any member of cabinet, deputy ministers, individual members of parliament, and committees could introduce a bill to propose fiscal rules for South Africa.

Section 76 bills may be introduced in either the National Assembly (NA) or the National Council of Provinces (NCOP) but must be considered in both Houses. Furthermore, members of the NCOP do not vote as individuals on Section 76 Bills but rather as provincial delegations.

The specific mechanics of fiscal rules would depend on the particulars of how the legislation is drafted, however, the amendment thereof or repealing of fiscal rules once passed in Parliament would be a function of Parliament i.e. National Treasury and/or the Minister of Finance would not be able to unilaterally scrap or amend the fiscal rules once adopted.

The legislation could either prohibit the National Treasury from tabling a fiscal framework and budget that does not comply with the fiscal rules, unless an escape clause has been triggered by Parliament ahead of tabling the budget. Alternately it could dictate the procedure that needs to be followed if the fiscal rules are breached, for example tabling a report along with the budget, setting out the reasons for not complying with the rules, and a detailed recovery plan.

WHAT WOULD AN INITIAL APPROPRIATE SPENDING-TO-GDP LIMIT BE?

The initial maximum level of government spending will thus be one that is consistent with a debt-stabilising primary balance. To derive this, one first needs to calculate the initial debt-stabilising primary balance. The standard approach is the formula:⁵⁵

$$s = \frac{r - g}{1 + g} b$$

⁵⁴ See Fiscal Responsibility Bill (B5-2020) and Responsible Spending Bill (B9-2023)

⁵⁵ For the full derivation, see Havemann and Hollander (2024).

Where s is the debt-stabilising primary balance, r is the interest rate on government debt, g is the economic growth rate and b is the level of debt as a share of GDP. One can use either real or nominal variables for r and g .⁵⁶ Here we use nominal variables.

We use the following values for the estimation of s in 2026/27:

- **Based on the 2024 MTBPS debt is estimated to reach 75.5% of GDP in 2025/26.** Based on this estimation, **b would be 75.5%** and kept constant in the initial debt stabilisation phase, before transitioning over to a debt reduction phase.
- For r , we use the estimated average rate of interest on government debt for 2026/27 and 2027/28, calculated from the MTBPS, giving a value of 6.95%.

For g we use the BER's growth forecast for nominal GDP for 2026/27 and 2027/28, which gives us 6.4% in 2026/27 and 6.1% in 2027/28.

Assuming no fiscal slippage in 2025/26, the outcome is that the debt-stabilising primary balance is a primary surplus of 0.39% in 2026/27 and 0.60% in 2027/28.

Our assumption for long-run revenue is more conservative than NT and we assume that revenue will be approximately 24% of GDP.⁵⁷

Thus, the initial maximum non-interest government spending to GDP ratio that is consistent with the required primary surplus is 23.6% of GDP in 2026/27 and 23.4% in 2027/28. This is slightly higher than the current NT projections of 22.8% and 22.4%.

In short, NT's projections are that it is on track to achieve a fiscal path that falls within our framework. This, however, relies on NT keeping spending under control. Moreover, the current fiscal projections have been the subject of concerns, with Fitch Ratings noting that the projections at the time of the 2024 MTBPS were optimistic.⁵⁸

Notably, if one were to use NT's more optimistic nominal GDP growth forecasts of 6.5% in 2026/27 and 6.6% in 2027/28, the initial required primary surplus would be lower, at 0.32% and 0.25%. Consequently, this would also imply a higher maximum non-interest government spending to GDP limit.

The BER's own assessment is that both the revenue forecast and the spending forecast are over-optimistic. While NT projects that it will meet its target, many market participants are of the view that it will not. This is thus the crux – NT is essentially implementing an appropriate rule at the moment on paper, the question is only whether it has the discipline to implement the rule

⁵⁶ Havemann and Hollander (2024) use nominal variables, technically because there are different deflators adding another layer of complexity. Moreover, they calculate r following the approach set out in Blanchard (2019), which adjusts r for a range of factors. This is all technically correct, but does not have a big impact on the calculation outcome. Here, we rather use a simpler approach with real values for each of the variables and no adjustments.

⁵⁷ Revenue as a share of GDP has fluctuated between 20 and 25% of GDP, gradually rising from 20% of GDP in 1996/97 to a peak of 25% of GDP during the post-COVID 'bump'. NT's forecast for revenue as a share of GDP is for it to rise to 24.8% of GDP by 2026/27. This would be the highest level in history – higher than even the post-COVID period, and higher than even the pre-global financial crisis fiscal boom of 23.4%.

⁵⁸ Fitch notes its more conservative assumptions. It has national government debt/GDP reaching 76.9% in FY26. Its assessment does highlight that a new debt strategy together with the use of deposits could create a "durable stabilisation in debt/GDP".

for the foreseeable future and achieve the rule in practice. This is the heart of the fiscal credibility problem facing NT.

Conclusion

Fiscal rules are not a silver bullet, and in isolation, would not address South Africa’s fiscal sustainability or credibility issues. However, with sufficient political buy-in, an appropriate design and a supportive institutional organisation, it could provide positive signalling value and assist in improving fiscal sustainability and credibility. It is furthermore argued that the true value of fiscal rules is to contain fiscal policy during economic upswings (periods of “economic plenitude”).

NT is essentially following the appropriate fiscal strategy at present, aiming to achieve a primary surplus that is consistent with debt-stabilisation. We propose to bolster this with a consumption expenditure-to-GDP rule that will serve as an operational target. This will ensure that the burden of consolidation falls on consumption spending and not investment spending.

Keeping on that path is the challenge. Imposing a legislated fiscal rule now could bind future governments to keep to that path – even if the days of plenty come – in so doing, ensuring that we do not have a repeat of previous mistakes.